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Director of Central Intelligence

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Chronology: August Crisis and September Reaction in Mexico

5 August	Dual exchange rate announced. Preferential rate set at 50 pesos to the dollar. General rate falls to 120 pesos to the dollar by the end of the month.
12 August	Banks closed and all foreign exchange trading suspended. Dollar accounts frozen.
16 August	Banks reopen with a triple exchange rate system: a preferential rate, a rate for withdrawals from dollar accounts, and a general rate.
17 August	Mexico begins negotiations with IMF. Details of financial aid package with US and other central bankers announced.
18 August	Price controls extended for 90 days. Tax breaks to aid private sector and a 35-percent reduction in personal income taxes announced.
20 August	Ninety-day debt moratorium with commercial bankers begins.
1 September	Lopez Portillo nationalizes banks and extends exchange controls.
2 September	Carlos Tello appointed as new head of the Bank of Mexico.
5 September	Dual exchange system reestablished with general rate pegged at 70 pesos to the dollar and preferential rate set at 50 pesos.
7 September	Finance Minister retracts press statements on unilateral postponement of debt repayments through 1983. Reaffirms commitment to IMF.
8 September	Planned protest by Monterrey businessmen called off.
15 September	Public sector workers granted an average 7-percent wage hike.
21 September	Anticorruption legislation sent to Congress.

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SPECIAL ANALYSES

13 MEXICO: Economic Trends

4 *President Lopez Portillo continues to avoid dealing with the difficult realities of the financial crisis. He is frustrated by the demands of international financiers for cuts in consumption and in government spending, and he has been seeking alternatives to an IMF program. Mexico City has virtually no foreign exchange available and is barely able to meet interest payments on public sector obligations.* [redacted] 25X

Lopez Portillo remains unpredictable, but Mexico probably will eventually adopt an IMF-endorsed austerity program. [redacted] 25X 25X

1/3 Press reports state that aides to President-elect de la Madrid believe Lopez Portillo is adopting short-term, populist measures and leaving the difficult decisions to the next administration. [redacted] 25X 25X

5 Although de la Madrid has not yet announced his policies, he does not intend to take the country toward socialism. He has stated, in tacit criticism of Lopez Portillo, that the mixed economy will continue and that the private sector has enough room to develop new initiatives. [redacted] 25X

Policy Alternatives

4 Even if Lopez Portillo negotiates an agreement with the IMF for an austerity program, major adjustments in Mexico's policy will continue to be reluctant, tentative, and slow. The President will not provide the leadership needed to build a political consensus for a tough stabilization program. [redacted] 25X

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Other options being explored include new laws to require Mexicans to repatriate the $22 billion Lopez Portillo claims they recently transferred abroad and negotiations for some multibillion dollar emergency loans
2/4 from foreign governments. Efforts to force Mexicans to bring back even a small portion of their money probably will fail, because foreign governments are unlikely to cooperate, and most Mexicans have already concealed their overseas holdings. Large new loans from friendly Western governments or OPEC nations are unlikely if Mexico does not accept conditions similar to those required by the IMF or give OPEC control over Mexican oil prices and exports. [redacted] 25X

Unilateral suspensions of payments on debts also are under consideration. Mexico City probably will avoid
4 such a step because it would make needed new loans unavailable and would damage national pride by giving the impression that Mexico is bankrupt. [redacted] 25X

The Next Three Months

The foreign exchange shortage has caused a severe reduction in imports and economic growth, and inflation has skyrocketed. At the end of the current debt morato-
4 rium on 23 November, Mexico will face immediate debt service obligations of $10 billion. To avoid default and further cutbacks in imports, Mexico will have to arrange new extensions for repaying its debts. [redacted] 25X

Government officials have said $5 billion in new loans will be needed for the remainder of 1982 to cover food and raw materials essential to keep the economy
4 going. Shortages of key imported raw materials and intermediate goods will soon cause more production cuts at state-owned and private enterprises, adding to unemployment and to inflationary pressures. [redacted] 25X

In the last three months of 1982, economic activity is likely to fall by about 3 percent. Inflation probably
4 will remain at about an 80-percent annual rate because of further cuts in imports, continued high government spending, and wage increases for public- and private-sector workers. [redacted] 25X

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Unemployment is likely to increase sharply. The government has just laid off a large number of construction workers, cutting back work on the Mexico City subway and on other investment projects. The private sector also has laid off substantial numbers of workers in automobile and other industries. [redacted] 25X

The public-sector deficit probably will rise as a result of increased subsidies for commercial credits and consumption, the 7-percent wage increase for public-sector workers, and the government's support for failing businesses. The current account will be forced into near balance because of the devaluation, import controls, and the difficulty of obtaining credit. [redacted] 25X

For the year as a whole, economic performance will be substantially worse than in 1981. Overall growth will be only about 2 percent, compared with 8.1 percent in 1981. Inflation is likely to be two-and-a-half times as high as last year. [redacted] 25X

<u>Tasks for de la Madrid</u>

In the short run de la Madrid will be forced to reduce government spending substantially and to cope with rising unemployment. Over the longer term his chief goals will be to restore public confidence in the honesty and effectiveness of the ruling party and government establishment and to develop an economic strategy to deal with Mexico's huge debt. [redacted] 25X

The President-elect faces an unprecedented test of the ruling party's ability to win over and incorporate disaffected elements into the system without resorting to repression. His ability to handle these problems, however, is uncertain. Unlike Lopez Portillo six years earlier, he will be unable to count on the promise of greatly increased petroleum revenues to meet Mexico's obligations. [redacted] 25X

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